

## Message Text

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ORIGIN EB-08

INFO OCT-01 EUR-12 IO-13 ISO-00 SP-02 ICA-11 AID-05  
NSC-05 TRSE-00 SS-15 STR-07 OMB-01 CEA-01 L-03  
H-01 PA-01 CIAE-00 COME-00 FRB-03 INR-10 NSAE-00  
XMB-02 OPIC-03 LAB-04 SIL-01 ITC-01 /110 R

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APPROVED BY EB/ITP:WBARRACLOUGH  
TREAS:RSELF  
EUR/WE:KSMITH  
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P R 291327Z AUG 78  
FM SECSTATE WASHDC  
TO AMEMBASSY MADRID PRIORITY  
INFO AMEMBASSY BRUSSELS  
USMISSION GENEVA  
AMEMBASSY PARIS  
AMEMBASSY BONN  
AMEMBASSY COPENHAGEN  
AMEMBASSY DUBLIN  
AMEMBASSY THE HAGUE  
AMEMBASSY LONDON  
AMEMBASSY LUXEMBOURG  
AMEMBASSY ROME

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USEEC /USOECD ALSO FOR EMBASSY

E.O. 11652: N/A

TAGS: ETRD, SP

SUBJECT: COUNTERVAILING DUTIES -- NON-RUBBER FOOTWEAR,  
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OLIVES AND ZINC FROM SPAIN

REF: STATE A-2264

1. THE TREASURY DEPARTMENT WILL PUBLISH IN THE FEDERAL  
REGISTER OF AUGUST 29 NOTICE OF ITS DECISION TO REVIEW THE  
BASES UPON WHICH IT REVISED ON JUNE 15 THE COUNTERVAILING

DUTY RATES ON NON-RUBBER FOOTWEAR, OLIVES AND ZINC FROM SPAIN (REFAIR). AS A RESULT OF THAT DECISION, THE ISSUE HAS BEEN RAISED OF THE CONSISTENCY OF THE TREASURY'S TREATMENT OF CASCADE TURNOVER TAXES (SUCH AS SPAIN'S DESGRAVACION FISCAL) WITH ITS TREATMENT OF VALUE-ADDED TAXES. TO HELP RESOLVE THIS QUESTION AS QUICKLY AS POSSIBLE, TREASURY HAS SENT A LETTER TO ALL PARTIES WITH A KNOWN INTEREST IN THESE AND SIMILAR SPANISH CASES, INCLUDING THE SPANISH EMBASSY AND U.S. COUNSEL FOR THE SPANISH PRODUCERS, INVITING THEIR COMMENTS BY SEPTEMBER 15 ON SOME BASIC LEGAL AND ECONOMIC ISSUES INVOLVED IN THE JUNE DECISION.

2. FOLLOWING ARE KEY PORTIONS OF THE LETTER TO INTERESTED

PARTIES THAT WILL BE INCLUDED IN THE FEDERAL REGISTER NOTICE: BEGIN TEXT.

IN JUNE OF THIS YEAR THE TREASURY DEPARTMENT PUBLISHED THREE NOTICES MODIFYING THE RATE OF COUNTERVAILING DUTIES ON NON-RUBBER FOOTWEAR, OLIVES AND ZINC FROM SPAIN. A NOTICE PUBLISHED CONCURRENTLY WITH THOSE NOTICES (43 F.R. 25812, JUNE 15, 1978) EXPLAINED THAT THE DOWNWARD REVISION IN THE CALCULATION OF THE BOUNTIES OR GRANTS WAS OCCASIONED BY THE BELIEF THAT, IN INTERPRETING THE COUNTERVAILING DUTY LAW IN RELATION TO THE EXPORT REBATE LIMITED OFFICIAL USE

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OF INDIRECT TAXES, IT WOULD BE INAPPROPRIATE TO DENY AN EXPORTER IN A COUNTRY USING A CASCADE TURNOVER TAX SYSTEM (SUCH AS THE SPANISH DESGRAVACION FISCAL) TREATMENT EQUIVALENT TO THAT ACCORDED AN EXPORTER FROM A COUNTRY USING A VALUE-ADDED TAX SYSTEM. ACCORDINGLY, IT WAS CONCLUDED THAT THE REBATE ON EXPORTATION OF ANY "TAXES PAID ON OR IN THE PROCESS OF MANUFACTURE OF THE EXPORTED PRODUCTS", AS OPPOSED TO ONLY THOSE IMPOSED DIRECTLY ON THE EXPORTED PRODUCTS OR THEIR COMPONENTS, WOULD NOT BE CONSIDERED A "BOUNTY" OR "GRANT" SUBJECT TO COUNTERVAILING DUTY. ...

"AS YOU KNOW, THE DEPARTMENT, FOR MANY YEARS, AND IN CONFORMITY WITH ARTICLE VI OF GATT, HAS TREATED THE EXPORT REBATE OF DIRECT TAXES, SUCH AS INCOME OR SOCIAL SECURITY TAXES, AS "BOUNTIES" OR "GRANTS" UNDER THE COUNTERVAILING DUTY LAW. BUT IT HAS VIEWED THE EXPORT REBATE OF INDIRECT TAXES, SUCH AS SALES, EXCISE, OR VALUE-ADDED TAXES, AS PERMISSIBLE UNDER THE LAW. THIS POSITION WAS RECENTLY AFFIRMED BY THE SUPREME COURT IN ZENITH RADIO CORPORATION V. UNITED STATES. FURTHER, FOR MORE THAN A DECADE, WE HAVE TAKEN THE POSITION THAT EXPORT

REBATES OF INDIRECT TAXES ARE BOUNTIES OR GRANTS UNDER THE COUNTERVAILING DUTY LAW IF, WHEN ASSESSED IN THE HOME MARKET, THEY ARE NOT DIRECTLY RELATED TO THE EXPORTED PRODUCT OR ITS COMPONENTS. THIS DISTINCTION WAS AFFIRMED BY THE COURT OF CUSTOMS AND PATENT APPEALS IN AMERICAN EXPRESS COMPANY V. UNITED STATES, 472 F.2D 1050, 60 CCPA 86 (1973).

"IN MAKING OUR DECISION IN THE CASES CONCERNING PRODUCTS IMPORTED FROM SPAIN ANNOUNCED IN JUNE, IT WAS RECOGNIZED THAT UNDER A VALUE-ADDED TAX SYSTEM A NUMBER OF INPUTS OR ELEMENTS IN THE MANUFACTURING PROCESS, WHICH ARE NOT "COMPONENTS" OF THE FINAL PRODUCT, ARE, NEVERTHELESS, SUBJECT TO TAXATION AT INTERMEDIATE STAGES OF THE LIMITED OFFICIAL USE

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PRODUCTION PROCESS AND, AT THE FINAL STAGE, THE ENTIRE VALUE-ADDED TAX MAY BE REBATED, (INCLUDING, THEREBY THE TAX COMPONENT OF THE FINAL PRODUCER'S OR SELLER'S COSTS). UNDER THE DESGRAVACION FISCAL ON THE OTHER HAND, REBATES FOR ELEMENTS TAXED WHICH ARE NOT "COMPONENTS" OF THE FINAL OF THE FINAL PRODUCT (SUCH AS MACHINERY) WERE NOT ALLOWED PRIOR TO THE JUNE DECISION.

"IT HAS BEEN ARGUED THAT BASIC EQUITY REQUIRES GREATER UNIFORMITY OF TREATMENT THAN HAD BEEN ACCORDED PREVIOUSLY; THAT ALLOWING THE REBATE OF TAXES ON COMPONENTS BUT NOT ON THE MANUFACTURING PROCESS, ELEVATED FORM OVER SUBSTANCE; THAT THE SYSTEM USED PENALIZED A COUNTRY FOR THE METHOD IT CHOSE TO EMPLOY IN ASSESSING INDIRECT TAXES. ON THE OTHER HAND, IT HAS BEEN ARGUED THAT THE EXISTING NATIONAL AND INTERNATIONAL RULES ON THE BORDER TREATMENT OF TAXES ARE THEMSELVES AN ELEVATION OF FORM OVER SUBSTANCE. UNDER A VALUE-ADDED TAX SYSTEM, WHATEVER INDIRECT ELEMENTS MAY HAVE BEEN TAXED AT INTERMEDIATE STAGES, THE FINAL STAGE TAX IS ALL THAT IS REBATED AND THAT TAX UNQUESTIONABLY IS DIRECTLY UPON THE PRODUCT. FURTHER, UNDER A VALUE-ADDED TAX SYSTEM, ALL TAXES ASSESSED AT INTERMEDIATE STAGES ARE REBATED OR CREDITED FULLY, REGARDLESS OF WHETHER THE PRODUCT IS EXPORTED, AND ONLY THE FINAL DOMESTIC PURCHASER OF A PRODUCT BEARS ANY TAX BURDEN. UNDER THE DESGRAVACION FISCAL, HOWEVER, THERE ARE NO REBATES OR CREDITS AT INTERMEDIATE STAGES AND THE EXPORTING MANUFACTURER, IN BEARING A TAX BURDEN ON HIS DOMESTIC SALES THAT HE WOULD NOT BEAR UNDER A VALUE-ADDED TAX SYSTEM, REALIZES A GREATER RELATIVE BENEFIT BY VIRTUE OF EXPORT REBATES OF THE CUMULATIVE TAX. ADDITIONALLY, IT IS ARGUED THAT, IN ALLOWING THE REBATE OF TAXES SPECIFICALLY IMPOSED UPON NONCOMPONENTS, SUCH AS MACHINERY, THE DISTINCTION LIMITED OFFICIAL USE

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TION BETWEEN DIRECT AND INDIRECT TAXES IS BLURRED AND IT BECOMES MORE DIFFICULT TO DISTINGUISH BETWEEN TAXES ON MACHINERY OR OTHER CAPITAL EQUIPMENT AND TAXES ON LABOR, FOR ALL CAN BE SAID TO BE DIRECTLY RELATED TO THE PRODUCTION PROCESS.

"IN ADDRESSING THIS QUESTION, CAREFUL ATTENTION NEEDS TO BE PAID TO WHATEVER GUIDANCE IS AVAILABLE FROM DECIDED CASES, PARTICULARLY THE ZENITH AND AMERICAN EXPRESS CASES NOTED ABOVE. FURTHER, WE ARE NOT AWARE OF, AND WOULD APPRECIATE ANY INFORMATION CONCERNING WHETHER ANY OTHER COUNTRY, IN APPLYING ITS COUNTERVAILING DUTY OR OTHER SIMILAR LAWS, HAS ADDRESSED OR RESOLVED A SIMILAR QUESTION ARISING FROM A CASCADE TURNOVER-TYPE TAX SYSTEM. AT THE HEART OF THE ISSUE IS THE INTERPRETATION TO BE GIVEN THE PHRASE "DIRECTLY RELATED". DOES A MORE EXPANSIVE DEFINITION OF THAT PHRASE CREATE TOO MANY DIFFICULTIES AND UNCERTAINTIES, ADMINISTRATIVELY, ECONOMICALLY, AND LEGALLY? OR CAN IT BE INTERPRETED CONSISTENTLY TO AVOID DIFFERENTLY, UNEQUAL RESULTS UNDER DISSIMILAR TAX SYSTEMS WITHOUT DISTURBING OR CONFUSING THE FIRM DISTINCTION BETWEEN DIRECT AND INDIRECT TAXES?...  
END TEXT.

3. SPANISH EMBASSY HAS CONVEYED UNDERSTANDABLE CONCERN OF GOS IN A DIPLOMATIC NOTE DELIVERED AUGUST 18 (COPY BEING POUCHED) AND IN EXTENSIVE CONVERSATIONS WITH STATE AND TREASURY OFFICIALS, INCLUDING TREASURY DAS EHREHAFT. SPANISH CONCERNS CENTER LARGELY ON THE SYMBOLIC IMPORTANCE OF THE TREASURY REVIEW COMING ON THE HEELS OF THE FAVORABLE JUNE REVISIONS AND ON THE TRADE DISRUPTION THAT COULD RESULT WHILE THE REVIEW IS BEING CONDUCTED. IN RESPONSE WE HAVE BEEN MAKING FOLLOWING POINTS TO EMBASSY:

-- THE DESCRIPTION OF THE SPANISH TAX SYSTEM PROVIDED TO  
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THE TREASURY BY THE GOS IS NOT AT ISSUE; RATHER THE QUESTION IS ONE OF BASIC PRINCIPLE THAT AFFECTS A BROAD RANGE OF IMPORTS FROM MANY COUNTRIES.

-- THIS REVIEW DOES NOT PREJUDGE THE EVENTUAL DECISION ON THE APPROPRIATE CVD FOR SHOES, OLIVES AND ZINC. DEPENDING ON HOW THE FUNDAMENTAL ISSUE IS RESOLVED,

THESE CVD'S MAY NOT CHANGE AT ALL AS A RESULT OF THIS REVIEW, OR THEY MAY INCREASE SOMEWHAT. IN ANY EVENT, THEY WILL NOT RPT NOT RISE TO THE PRE-JUNE 15 LEVEL, SINCE MANY OF THE ADJUSTMENTS MADE AT THAT TIME WOULD NOT BE AFFECTED BY THIS REVIEW.

-- TREASURY WANTS TO RESOLVE THIS QUESTION AS QUICKLY AS POSSIBLE IN ORDER TO MINIMIZE THE UNCERTAINTY FOR SPANISH AND OTHER EXPORTERS.

-- WE ENCOURAGE THE GOS TO SUBMIT FURTHER COMMENTS ON THE LEGAL AND ECONOMIC ASPECTS OF THE QUESTION NOT ONLY AT NEXT MONTH'S JOINT ECONOMIC COMMITTEE BUT ALSO IN WRITTEN FORM BEFORE SEPTEMBER 15.

4. EMBASSY MAY DRAW ON ABOVE POINTS IN DISCUSSION WITH SPANISH GOVERNMENT AND INDUSTRY OFFICIALS. COPY OF FEDERAL REGISTER NOTICE WILL BE POUCHED UPON PUBLICATION. CHRISTOPHER

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## Message Attributes

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**TAGS:** ETRD, SP, US  
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